

THE STATUS OF TELECOMMUNICATIONS COMPETITION IN CALIFORNIA

Chapter 1. Executive Summary

I. Chapter Overview

This Report on the Status of Telecommunications Competition in California provides a review of telecommunications markets, trends, and competition issues including significant changes in the past few years. The data and discussions address the nature and scope of California and comparative national markets. Together these analyses encompass the competitive status and issues in the markets for local, local toll, long distance, wireless communications, and advanced services.

Staff from the California Public Utilities Commission's (CPUC or Commission) Telecommunications Division prepared this report in response to Section 316.5 of the California Public Utilities Code.

II. Findings

A. Traditional Markets: Incumbent Carriers Dominate Local & Local Toll

The traditional telecommunications markets are comprised of three major categories: local, local toll, and long distance service. Calls made within a 12-mile radius of one's residence or business are considered local, and are covered by a local service provider (e.g. Pacific Bell or Verizon). Calls made within one's Local Access and Transport Area (LATA),¹ but beyond that 12-mile radius, are considered local toll calls, and generally cost the user a per minute and time of day fee. Last, calls made from one LATA to another, otherwise known as long distance service, are carried by long distance companies such as AT&T, Worldcom², and Sprint.

¹ LATA: The geographic areas served by Regional Bell Operating Companies (RBOCs) and other local carriers. See the discussion on service types in Chapter 3 for more information.

² Formerly known as MCI Telecommunications Corporation

Competition in the local market is currently very limited. Data indicates that incumbent local exchange carriers (ILECs), such as Pacific Bell and Verizon, hold dominant positions both statewide and nationwide. In California, ILECs control between 94.0 and 96.4 percent of local phone lines, while Competitive Local Exchange Carriers (CLECs), such as Cox California Telecommunications and AT&T Local Services, control between 3.6 and 6.0 percent. CLECs have a larger share of the state's local business customers as compared to local residential customers. Numbering data corroborates the data regarding number of telephone lines. Specifically, ILECs hold about 89 percent of the state's assigned, wireline telephone numbers and CLECs hold just 11 percent. In terms of revenues, ILECs earned nearly 80 times what CLECs did from local telephone service in 2000.³ Generally, CLECs rely more on facilities-based and Unbundled Network Elements (UNE) modes of entry to make in-roads into local markets. With two percent of assigned telephone numbers, CLECs have hardly penetrated the rural local markets.

While ILECs are also dominant in the local toll market, their competitors appear to be fairing somewhat better as compared to the local market. Between 1996 and 2000, CLECs/IXCs⁴ local toll revenues totaled approximately \$1.4 billion and ILECs local toll revenues were about 5 times that amount or \$6.7 billion. In 2000, ILECs retained 76 percent of total local toll revenues. However, CLECs/IXCs outpaced the incumbents in the rate of revenue growth from 1996 to 2000 (CLECs/IXCs 93 percent to ILECs 4 percent growth). CLEC/IXC customer share also grew from 19.3 percent to 24.3 percent of the total residential local toll subscribers in California in the period between 1999 and 2000.

The long distance market in California is exhibiting mixed signals. According to the data, long distance minutes of use in the state slowly grew between 1996 and 2000 while total long distance revenues declined to \$871 million by the end of 2000. In addition, certain carriers reported a decline in residential long distance subscribership in California during that period. It is unclear whether these divergent trends are indicative of changes in the competitive landscape for this market. On one hand, several long distance carriers contend that they are experiencing a downturn due to wireless, E-mail and Internet substitution as well as expanded ILEC calling areas. On the other hand, the changes may be attributable to shifting customer bases between long distance carriers and not actually represent a market decline. The state's long distance market may be further impacted if Pacific Bell receives approval to

³ ILECs earned \$5.8 billion, while CLECs earned \$74.5 million in 2000.

⁴ Long distance carriers are also called Inter-Exchange Carriers (IXCs)

expand its service offerings and enter the state's long distance market. The CPUC will continue to evaluate this market.

B. Wireless and Advanced Services Markets: More Competition in Wireless Than DSL

i. Wireless: A Growing Market

The wireless services market is exhibiting some increases in competitive activity, as at least five service providers are established in every area code. These providers include Verizon Wireless, Cingular, AT&T Wireless, Sprint and Nextel. Moreover, the wireless industry is growing, as demonstrated by a 48 percent increase in subscribership, with more than four million new customers from 1999 to 2000. Wireless service has become increasingly popular, with wireless carriers' plans offering customers unlimited local and long distance calls for no extra charge within their "bucket of minutes." However, the lack of "number portability" (i.e. the inability to take one's current telephone number to a new wireless carrier), high fees for breaking contracts, barriers to entry (such as limited spectrum bandwidth) and different technology standards, may prevent consumers from fully enjoying competition. Further, the potential for market share dominance by two or three top wireless carriers may reduce the number of choices consumers have in the wireless market. Industry oversight is necessary to keep this market segment open as it develops from its early stages into maturity.

ii. Advanced Services: Experiencing Market Challenges

In the "mass market" of residential and small business customers, consumers are gradually shifting from dial-up Internet access over ordinary telephone lines to high-speed or broadband services. In California, the two main forms of broadband service are digital subscriber line (DSL) service offered over telephone lines and cable modem service offered over upgraded cable television networks. California is the only state in the U.S. with higher DSL subscribership than cable modem subscribership. In California, cable modem broadband service is not an option for many customers because of its limited availability. For the nearly 25 million Californians living in areas with broadband service access in 2000, 11 million people in 210 communities lived in cities where DSL was the sole broadband option.

DSL competition is limited, and a number of DSL providers, such as NorthPoint and Rhythms NetConnections, have gone out of business. The CPUC estimates that Verizon, Pacific Bell, and their affiliates combined control roughly 90 percent of the DSL market in California. Competitors are dependent on the incumbent carriers (the ILECs) for network linkages in order to provide competitive alternatives to the incumbents' DSL service. Rules established by the FCC and the CPUC that set the prices and terms under which competitors can share the lines of incumbent carriers may be significant in determining the extent of competition in the DSL market.

C. Competitive Trends to Watch

The overall number of wireline carriers (local, local toll and long distance) actually serving customers has leveled off in recent years, as shown by the number of carriers remitting surcharge revenues to the CPUC. The economic downturn has had a particularly adverse effect on competitive DSL providers and on CLECs. Bankruptcies of CLECs and DSL competitors began in 2000 and accelerated in 2001 and early 2002. The number of CLECs requesting telephone numbers in order to serve customers declined from 52 to 40 between 2000 and 2001 and is expected to further decline in 2002.

The number of wireless carriers has fallen significantly (from 98 in 1996 to 57 in 2001), while wireless revenues have been increasing. This data suggests a trend of concentration and consolidation in the wireless market.

In both the wireline and wireless markets, mergers pose an additional threat to competition. However, occasionally, as in the inability of Northpoint to close its merger with Verizon, the failure of a merger can be harmful to competition.

The actions of California's largest ILEC, Pacific Bell, also have a direct impact on competition in California's telecommunications markets. A Commission decision on the matter of Pacific's Section 271 application, which requests entry into the long distance market, is pending. If all of the requirements of Section 271 are met, theoretically, competition would then increase in both the local and long distance markets. CLECs would be able to compete in the local market with far greater ease once the Section 271

requirements are met, and the long distance market will benefit by having one more carrier offer its services to consumers

The CPUC is taking a variety of steps to enhance the development of competition. Five issues that the CPUC is addressing are:)

- Pacific Bell's application to enter the long distance market: Pacific Bell will be authorized to provide long distance service if and when it has proven it has met a 14-point checklist for opening the local market to competitors.;
- The examination of UNE prices charged to ILEC competitors: the CPUC is working to ensure that prices for the leasing of ILEC network components are not set too high to discourage competition yet provide adequate recovery of costs for the ILECs.
- A review of the New Regulatory Framework (NRF) governing ILECs: the CPUC is examining whether the proper incentives are in place to encourage telecommunications competition in the state and to promote fair prices and high quality service,
- Advocacy before the FCC to promote broadband competition: the CPUC is opposing proposals that would undermine competition in the DSL market; and
- Number portability for wireless carriers: the CPUC is urging the FCC to enhance competition by extending number portability to the wireless industry.

Finally, while competition can promote lower prices, innovation, and improved service quality, competition can also present some challenges and hazards to consumers. Customers need full information in order to make informed choices and need protection from carriers who attempt to take advantage of the opportunities to victimize consumers presented by competition. To this end, the Commission is completing work on a Telecommunications Consumer Bill of Rights and a corresponding set of comprehensive consumer protection rules.

Table 1.1
Telecommunications Competition
Key Findings for California

TRADITIONAL MARKETS	
<i>Local Market</i>	<ul style="list-style-type: none"> • ILECs control between 94.0 and 96.4 percent of local phone lines • CLECs control between 3.6 and 6.0 percent of local phone lines • ILECs hold 89 percent of the wireline telephone numbers and CLECs hold just 11 percent • CLECs have a larger relative share of the state's local business customers than its local residential customers. They also have made more consistent gains with local business vs. local residential revenues. • CLECs have hardly penetrated rural markets, with 2 percent of assigned telephone numbers. • The number of CLECs requesting telephone numbers declined from 52 to 40 between 2000 and 2001 and is expected to further decline in 2002.
<i>Local Toll Market</i>	<ul style="list-style-type: none"> • ILEC total local toll revenues from 1996 through 2000 were \$6.7 billion • CLECs/IXC total revenues from 1996 through 2000 were \$1.4 billion • CLECs/IXCs are faring better in the local toll market than in the local market, with 24 percent of total local toll revenues and 24.3 percent of residential local toll customers in California for 2000.
<i>Long Distance Market</i>	<ul style="list-style-type: none"> • Long distance minutes of use in California grew slowly between 1996 and 2000 while long distance revenues in the state declined • Residential long distance subscribership for certain carriers has declined in the state. • AT&T has the greatest share of the residential long distance segment, followed by Worldcom and Sprint; but it is declining. Other competitors' share is increasing. • Pacific Bell is seeking to enter California's long distance market, pursuant to criteria defined in the Telecommunications Act of 1996.
WIRELESS AND ADVANCED SERVICES MARKETS	
<i>Wireless Market</i>	<ul style="list-style-type: none"> • There are at least five established service providers in every area code. • In 2000, wireless carriers reported 12.6 million subscribers and nearly \$6.5 billion in revenues. • Wireless carriers hold three times as many telephone numbers as CLECs and 40 percent of what ILECs held in 2000. • The wireless market is growing, with subscribership increasing 48 percent in 2000. • The lack of number portability, high fees for breaking contracts, limited spectrum bandwidth, and different technology standards may prevent consumers from fully enjoying competition. • Consolidation among wireless carriers is reducing the number of choices consumers have in the wireless market.
<i>Advanced Services Market</i>	<ul style="list-style-type: none"> • California is the only U.S. state with higher DSL subscribership than cable modem subscribership • In 2000, 11 million Californians in 210 communities lived in cities where DSL was the sole broadband option available • Competition in the DSL market is disintegrating as DSL providers are going out of business and ILECs and their affiliates control 90% of DSL lines • The success of competitors will be affected by their ability to share the lines of ILECs to provide DSL service